



TAX-EXEMPT AND  
GOVERNMENT ENTITIES  
DIVISION

DEPARTMENT OF THE TREASURY **PROTEST RECEIVED** **FILE**  
INTERNAL REVENUE SERVICE Release to Manager, EO Determinations - Cincinnati  
WASHINGTON, D.C. 20224

DATE: [REDACTED]

SURNAME: [REDACTED]

Date: MAR 4 2002

Contact Person: [REDACTED]

Identification Number: [REDACTED]

Contact Number: [REDACTED]

Employer Identification Number: [REDACTED]

Dear Applicant:

We have considered your application for recognition of exemption from federal income tax under section 501(a) of the Internal Revenue Code as an organization described in section 501(c)(3). Based on the information submitted, we have concluded that you do not qualify for exemption under that section. The basis for our conclusion is set forth below.

You were organized on [REDACTED] as a not-for-profit corporation under [REDACTED] law. Your Articles of Incorporation state that you were formed for the purpose of providing housing on a mutual ownership basis. You filed your Form 1023 Application for Recognition of Exemption on [REDACTED].

Your by-laws provide that any qualified natural person approved by the Board of Directors shall be eligible for membership. Members shall consist of all qualified persons, or their successors, who have been approved by the Board of Directors and have paid for their membership and received membership certificates. If a member desires to relinquish his or her unit, you have the first option to purchase the membership. If you do not exercise your option to purchase the membership, the member may sell his or her membership. Upon the death of a member, his or her membership may pass by will or intestate distribution to a member of the immediate family. If it does not, you have the first right and option to purchase the membership.

In your application, you state that you are a housing cooperative consisting of [REDACTED] units. Your primary function is to provide housing on a non-profit basis to your members. The "Handbook -- [REDACTED]" states that you are responsible for the maintenance of the grounds and building exteriors. You also perform repairs and maintenance inside the buildings. Your financial support comes primarily from monthly member carrying charges.

Accompanying your application is a handbook that you distribute to new members titled [REDACTED]. One section of that handbook addresses "matters affecting carrying charges," in which it is stated:

The carrying charges paid by the individual member together with those of his neighbors provide the funds necessary to meet the budget for the cooperative which has been submitted to and has been approved by the Federal Housing Administration. These monthly carrying charges will pay the mortgage charges, real estate and other taxes, the cost of administration, operation and maintenance of the development. Just as in any other business corporation, costs and expenses may change from time to time. You will note, therefore, that the Occupancy Agreement provides for an annual review of the carrying charges which may change as conditions require. Excess funds may be returned to members in the form of patronage refunds or reduced monthly charges.

In addition to normal expense items, your cooperative will also maintain reserve funds for your protection in the future. A General Operating Reserve of 3% of all receipts will be accumulated to protect the cooperative and its members against emergencies.

It is to be noted that as a resident-owner in a cooperative corporation you may deduct from your annual taxable income your proportionate share of the real estate taxes and mortgage interest paid by the corporation. These are the same deductions allowed to private home owners and constitute one of the major financial advantages of cooperative ownership. Your cooperative corporation will give you the applicable information annually.

Section 501(c)(3) of the Code exempts from federal income tax organizations that are organized and operated exclusively for charitable purposes.

Section 1.501(c)(3)-1(a)(1) of the Income Tax Regulations (the "regulations") provides that in order to be exempt as an organization described in section 501(c)(3), an organization must be both organized and operated exclusively for one or more of the purposes specified in such section.

Section 1.501(c)(3)-1(b)(1)(i) of the regulations provides that an organization is organized exclusively for one or more exempt purposes only if its articles of organization (a) limit the purposes of such organization to one or more exempt purposes; and (b) do not expressly empower the organization to engage, otherwise than as an insubstantial part of its activities, in activities which in themselves are not in furtherance of one or more exempt purposes.

Section 1.501(c)(3)-1(b)(4) of the regulations provides that an organization is not organized exclusively for one or more exempt purposes unless its assets are dedicated to an exempt purpose. An organization's assets will be considered dedicated to an exempt purpose, for example, if, upon dissolution, such assets would, by reason of a provision of the organization's articles or by operation of law, be distributed for one or more exempt purposes, or to the Federal government, or to a State or local government, for a public purpose, or would be distributed by a court to another organization to be used in such manner as in the judgment of the court will best accomplish the general purposes for which the dissolved organization was organized.

Section 1.501(c)(3)-1(c)(1) of the regulations provides that an organization will be regarded as "operated exclusively" for one or more exempt purposes only if it engages primarily in activities which accomplish one or more of such exempt purposes specified in section 501(c)(3). An organization will not be so regarded if more than an insubstantial part of its activities is not in furtherance of an exempt purpose.

Section 1.501(c)(3)-1(c)(2) of the regulations provides that an organization is not operated exclusively for one or more exempt purposes if its net earnings inure in whole or in part to the benefit of private shareholders or individuals.

Section 1.501(a)-1(c) of the regulations provides that the words "private shareholder or individual" in section 501 refer to persons having a personal and private interest in the activities of the organization.

Section 1.501(c)(3)-1(d)(1)(ii) of the regulations provides that an organization is not organized or operated exclusively for one or more exempt purposes unless it serves a public rather than a private interest. Thus, to meet the requirements of this subdivision, it is necessary for an organization to establish that it is not organized or operated for the benefit of private interests such as designated individuals, the creator or his family, shareholders of the organization, or persons controlled, directly or indirectly, by such private interests.

Section 1.501(c)(3)-1(d)(2) of the regulations provides that the term "charitable" is used in section 501(c)(3) in its generally accepted legal sense. Such term includes relief of the poor and distressed or of the underprivileged.

Rev. Proc. 96-32, 1996-1 C.B. 717, sets forth a safe harbor under which organizations that provide low-income housing will be considered charitable as described in section 501(c)(3) because they relieve the poor and distressed. An organization will be considered charitable under section 501(c)(3) if (1) the organization establishes for each project that (a) at least 75% of the units are occupied by residents that qualify as low-income; and (b) either at least 20% of the units are occupied by residents that also meet the very low income limit for the area or 40 percent of the units are occupied by residents who also do not exceed 120% of the area's very low income limit; (2) the project is actually occupied by poor and distressed residents; and (3) the housing is affordable to the charitable beneficiaries. An organization originally meeting the safe harbor will continue to satisfy the requirements of the safe harbor if a resident's income does not exceed 140 percent of the applicable income limit under the safe harbor. If the resident's income exceeds 140 percent of the qualifying income limit, the organization will not fail to meet the safe harbor if it rents the next comparable non-qualifying unit to someone under the income limits. If the safe harbor is not satisfied, an organization may demonstrate that it relieves the poor and distressed by reference to all the surrounding facts and circumstances.

Rev. Rul. 71-395, 1971-2 C.B. 228, describes a cooperative art gallery formed and operated by a group of artists for the purpose of exhibiting, renting, and selling their works. The ruling concludes that by showing and selling only the works of its members, the cooperative serves their private interests and thus does not qualify for exemption as educational, even

thought the exhibition and sale of paintings may be an educational activity in other respects.

Rev. Rul. 69-175, 1969-1 C.B. 149, describes an organization formed by the parents of pupils attending a private school exempt under section 501(c)(3) of the Code. The organization provides bus transportation to and from the school for those children whose parents belong to the organization. All control over the organization rests in the parents. The ruling concludes that when individuals associate to provide cooperative services for themselves, they are serving a private interest. By providing bus transportation for school children, the organization enables the participating parents to fulfill their individual responsibility of transporting their children to school. Since the organization serves a private interest, it is not exempt under section 501(c)(3) of the Code.

You are a housing cooperative. Your purpose is to provide housing to your members. An organization that provides housing will be considered to be organized and operated for charitable purposes within the meaning of section 501(c)(3) of the Code if it can demonstrate that its activities provide relief of the poor and distressed or of the underprivileged, or if its activities serve to combat community deterioration, lessen the burdens of government, or eliminate discrimination and prejudice. Even if an organization can demonstrate that its activities serve a charitable purpose, it must also demonstrate that it serves a public interest rather than the private interest of its members.

You are not organized exclusively for charitable purposes because your Articles of Incorporation do not indicate that, in providing housing to your members, you necessarily serve persons who are considered poor and distressed, or that you provide benefits that serve any other charitable purpose.

You have failed to demonstrate that in providing cooperative housing you are operated for a charitable purpose. There is no indication that you benefit primarily the poor and distressed as contemplated by Rev. Proc. 96-32, *supra*. Rather, your membership is open to "any qualified natural person ... approved by the Board of Directors." Since a membership can pass by will, intestacy, or sale, there is no guarantee that a particular housing unit or a certain number of housing units will become available to persons who are poor and distressed. Nor is there any indication that your activities serve other charitable purposes.

You are not operated exclusively for a charitable purpose because your net earnings inure in part to your members insofar as they receive the value of their membership upon selling their membership. Furthermore, your cooperative structure necessarily results in you serving the private interests of your members more than incidentally: it enables members to deduct from their taxable income their proportionate share of the real estate taxes and mortgage interest paid by you, and provides cost sharing in the management and maintenance of their units. In that respect, you are similar to the organizations described in Rev. Rul. 71-395, and Rev. Rul. 69-175, *supra*, in which individuals, by working on a cooperative basis, were able to provide services to themselves more conveniently and cheaply than if they had each purchased such services separately.

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Accordingly, you do not qualify for exemption as an organization described in section 501(c)(3) of the Code and you must file federal income tax returns.

Contributions to you are not deductible under section 170 of the Code.

You have the right to protest this ruling if you believe it is incorrect. To protest, you should submit a statement of your views to this office, with a full explanation of your reasoning. This statement, signed by one of your officers, must be submitted within 30 days from the date of this letter. You also have a right to a conference in this office after your statement is submitted. You must request the conference, if you want one, when you file your protest statement. If you are to be represented by someone who is not one of your officers, that person will need to file a proper power of attorney and otherwise qualify under our Conference and Practices Requirements.

If you do not protest this ruling in a timely manner, it will be considered by the Internal Revenue Service as a failure to exhaust available administrative remedies. Section 7428(b)(2) of the Code provides, in part, that a declaratory judgement or decree under this section shall not be issued in any proceeding unless the Tax Court, the United States Court of Federal Claims, or the District Court of the United States for the District of Columbia determines that the organization involved has exhausted administrative remedies available to it within the Internal Revenue Service.

If we do not hear from you within 30 days, this ruling will become final and a copy will be forwarded to the Ohio Tax Exempt and Government Entities (TE/GE) office. Thereafter, any questions about your federal income tax status should be directed to that office, either by calling 877-829-5500 (a toll free number) or sending correspondence to: Internal Revenue Service, TE/GE Customer Service, P.O. Box 2508, Cincinnati, OH 45201. The appropriate State Officials will be notified of this action in accordance with Code section 6104(c).

When sending additional letters to us with respect to this case, you will expedite their receipt by using the following address:

Internal Revenue Service  
████████████████████ T:EO:RA:T:2  
1111 Constitution Ave, N.W.  
Washington, D.C. 20224

[REDACTED]

If you have any questions, please contact the person whose name and telephone number are shown in the heading of this letter.

Sincerely,

(signed) Terrell M. Berkovsky  
Terrell M. Berkovsky  
Manager, Exempt Organizations  
Technical Group 2

cc:

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]